

## Internal Revenue Service

Department of the Treasury  
Washington, DC 20224

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X =

A =

B =

Grantor =  
Trust

=  
Family  
Trust  
=

State  
D1 =  
D2 =  
D3 =  
D4 =  
D5 =

Dear :

This responds to a letter dated October 22, 2008, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

## FACTS

The information submitted states that X was incorporated in State on D1. X made an election to be treated as an S corporation effective D2. At that time Grantor Trust was a shareholder of X. A was the grantor of Grantor Trust. A died on D3. Upon A's death, Grantor Trust became irrevocable. Grantor Trust provided for the transfer of its shares of X to Family Trust. Grantor Trust became an ineligible shareholder of X on D4. Because Grantor Trust inadvertently failed to transfer its shares of X to Family Trust by D4, X's S corporation election terminated on D4. Grantor Trust transferred its shares of X to Family Trust on D5. B was the current income beneficiary of Family Trust, but B failed to make a timely qualified subchapter S trust (QSST) election.

X represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X and its shareholders consent to make any adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary.

## LAW AND ANALYSIS

Section 1361(a)(1) of the Code provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that, for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Prior to the Small Business Job Protection Act of 1996, Section 1361(c)(2)(A)(iii) provided that for purposes of § 1361(b)(1)(B), a trust with respect to stock transferred to it pursuant to the terms of a will may be a shareholder, but only for the 60 day period beginning on the day on which such stock is transferred to it. The Small Business Job Protection Act of 1996 changed the 60 day period to a 2 year period, effective for tax years beginning after December 31, 1996.

Section 1361(d)(1) provides that in the case of a QSST for which a beneficiary makes an election under § 1361(d)(2), the trust is treated as a trust described in § 1361(c)(2)(A)(i), and for purposes of § 678(a), the beneficiary of the trust shall be treated as the owner of that portion of the trust that consists of stock in an S corporation

with respect to which the election under § 1361(d)(2) is made. Section 1361(d)(2)(A) provides that a beneficiary of a QSST may elect to have § 1361(d)(1) apply.

Section 1.1361-1(j)(6)(ii) of the Income Tax Regulations provides that the current income beneficiary of a QSST must make the election under § 1361(d)(2) by signing and filing with the service center with which the corporation files its income tax returns the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1362(d)(2) provides that (A) in general, an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation and (B) any termination under § 1362(d)(2) shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation or (B) to acquire the shareholder consents; and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation will be treated as an S corporation during the period specified by the Secretary.

## CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election terminated on D4 and that the termination was inadvertent within the meaning of § 1362(f). We further hold that, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from D4 and thereafter, provided X's S corporation election was valid and provided that the election was not otherwise terminated under § 1361(d). Family Trust will be treated as a QSST from D5 until its termination. The shareholders of X must include their pro-rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat themselves as described above, this ruling is null and void.

This ruling is conditioned upon (1) B filing an appropriately completed QSST election effective D4; and (2) any affected shareholders of X filing any amended returns necessary to conform to this letter. The QSST election and any amended returns must be filed within 60 days following the date of this letter and a copy of this letter should be attached to any such elections or returns.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provisions of the Code. In particular, we express no opinion on whether Family Trust is otherwise eligible to be a QSST or whether X is otherwise eligible to be an S corporation.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file, a copy of this letter is being sent to X's first authorized representative.

Sincerely,

Melissa C. Liquerman  
Chief, Branch 2  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures: 2  
Copy of this letter  
Copy for § 6110 purposes